IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

No. 203

MANUFACTURERS' FINANCE COMPANY,
Petitioner,

vs.

DAVE MARKS, TRUSTEE IN BANKRUPTCY OF BELMONT CANDY COMPANY, BANKRUPT,
Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

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To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The brief of respondent is based primarily upon two assertions—first, that the courts below have found that a fraudulent preference existed, and second, that since petitioner had the "absolute and exclusive knowledge of all accounts paid" the burden was upon petitioner to establish all facts, and "that its failure to do so is of itself fraud on the other creditors, resulting in a presumption against the legitimacy of the payments" made to petitioner by bankrupt. We shall take these points up in order.

I.

This is not a case where a fraudulent preference or conveyance has been established by evidence produced in the record; on the contrary, the alleged fraudulent preference is grounded upon a presumption *wholly unsupported by the record.* We are here dealing with the *determination of whether a preference exists,* not with the legal situation which arises in connection with introducing evidence after a preference has been properly established.

The courts below based the preference allegedly secured by petitioner on the *presumption* that the indebtedness of $12,214.20 owing petitioner on July 1, 1932 (to secure which petitioner had assigned accounts in the aggregate amount of $18,632.82) (R. 271) was paid to petitioner exclusively out of the proceeds of accounts assigned thereafter. This is the vital crux of the opinions of the courts below and the only basis upon which any preference could exist. The Circuit Court of Appeals specifically grounded their opinion on that point, stating "The controlling question as to the item of $12,-214.20, for which the District Court gave judgment against the appellant, is the source of the collections made between June 30, 1932, and October 6, 1932, from which appellant reimbursed itself for this sum." (R. 349). The *only* claimed preference is that petitioner reimbursed itself for the sum of $12,214.20 owing it July 1, 1932 out of subsequently assigned accounts. (R. 341.)

The courts below recognized and specifically stated that the repayment of the sum of $12,214.20 to petitioner is justified only to the extent that such repayment was made out of accounts already on hand July 1, 1932 (R. 347). If, according to the opinion of the Cir-

cuit Court of Appeals, such sum was *not* repaid out of subsequently assigned accounts, *there obviously could be no recoverable preference.* If, on the other hand, such sum was paid out of subsequently assigned accounts then, according to the Circuit Court of Appeals' opinion, there was a recoverable preference. The existence or non-existence of the recoverable preference, therefore depends exclusively upon the question of whether such indebtedness was or was not paid out of subsequently assigned accounts. The Circuit Court of Appeals has held in such a situation that there is no burden upon the trustee to establish the facts which necessarily must be established before the preference can come into existence.

Respondent has attempted to create the impression that the alleged preference has already been established and that therefore, because of such preference, the burden of proof was upon petitioner rather than upon the trustee in bankruptcy to establish the facts in connection with which the preference was secured. He overlooks completely that these facts, wholly missing from the record, are necessarily and vital as a condition precedent to the establishment of the preference. The preference depends upon factual proof—that the indebtedness owing petitioner on July 1st was paid out of subsequently assigned accounts. Without such proof there can be no preference. There is no proof to such effect in the record and, as we have pointed out, the record is expressly to the contrary.

Under such circumstances it cannot be questioned under all of the decisions of this court and all other decisions on the subject that the burden was with the respondent throughout to establish the preference which he alleged.

Furthermore, it is obvious and indisputable on this record that it is impossible that the major portion or any substantial portion of the indebtedness of $12,214.20 owing petitioner July 1, 1932 was paid outof subsequently assigned accounts. This conclusion appears from the testimony of petitioner as well as that of respondent, *and is without contradiction.*

Primarily, the record conclusively shows that on July 1, 1932 petitioner had on hand valid, unassailable assignments of accounts in the aggregate sum of $18,632.85. Counting all of the accounts, both those on hand July 1, 1932 and all of those subsequently assigned to petitioner, the record shows that there now remain uncollected accounts in the total aggregate sum of $7,900.51 (R. 344). All other accounts have been collected. Even assuming that all of the uncollected accounts are accounts assigned prior to July 1, 1932 (which is not a very likely possibility but which is the very most that respondent could contend) *at least the difference or $10,732.34 was collected on accounts already on hand July 1, 1932.* This difference of $10,732.34, as we have above indicated, and which is obvious from the record, is the very *least* that could have been collected on accounts already on hand July 1, 1932 and applied toward the reduction of the indebtedness owing of $12,-214.20.

To approach the problem another way, but which leads to the same conclusion, it is admitted on the record that after July 1, 1932 the total number of accounts assigned to petitioner aggregated $71,067.47 (R. 345). It is further admitted on the record that after July 1, 1932 bankrupt collected and forwarded to petitioner in cash on assigned accounts receivable the sum of $78,-573.09 (R. 150). It is also admitted that the receiver

thereafter collected on such assigned accounts the sum of $431.30, that the trustee collected thereon the additional sum of $647.07, and that petitioner further collected thereon the additional sum of $1,941.32. Thus, the total amount of cash collected after July 1, 1932 on *all assigned accounts* is in the aggregate sum of $81,-592.78 (the total of the four items last mentioned), or *$10,525.31 over and above 100 per cent of the face amount of all accounts assigned subsequent to July 1, 1932.* We cannot emphasize too much that these facts are uncontradicted of record. Thus, it is obvious again that *at least* $10,525.31 was collected on accounts assigned pror to July 1, 1932 and that *at least* that much of the indebtedness of $12,214.20 owing petitioner July 1, 1932 was paid exclusively out of accounts already on hand July 1, 1932.

If, therefore, as the courts below have found, the determination of the question as to whether a preference exists depends upon the question of whether the indebtedness of $12,214.20 was paid to petitioner out of subsequently assigned accounts, it is obvious that the courts below have done exactly what we argued they did in our main brief—they have built a preference upon a presumption, wholly unsupported by, and contrary to the record, that a substantial part of such indebtedness owing to petitioner July 1, 1932 was paid out of subsequently assigned accounts; and upon a second presumption, built upon the first, that such entire indebtedness was paid *exclusively* out of accounts assigned subsequent to July 1, 1932. It is one thing to hold that where a fraudulent preference has been established, and where all of the evidence as to the money or property received by the fraudulent transferee is in his sole possession, the burden of proof then shifts to such transferee to establish the facts. It is quite another to hold

that the fundamental crux or foundation necessary to *establish* the preference itself must be shown *not to have existed* by the transferee against whom the cause of action is brought.

II.

Much confusion has been built up in the presentation of respondent's theory by reference to authorities which have no application to the facts of the case at bar and by numerous unwarranted and wholly unsupported statements calculated to convey an entirely improper impression of the facts of the case. This is particularly true with respect to the statements made as to the alleged control of Bradley over the business of the bankrupt after July 1, 1932. Without intending to go into factual matters at this time, a fair reading of the record shows that after a diversion of funds by bankrupt, petitioner insisted, as a condition to purchasing further accounts from bankrupt, that it station one of its traveling auditors in bankrupt's place of business to see that all collections on assigned accounts were turned over to petitioner. Bankrupt's president, testifying as a witness for the trustee in bankruptcy (this witness was and still is ~~the~~ receiver in bankruptcy for the bankrupt) stated (R. 107) that additional conditions were made—that he was to have the sole key to the mail box, have a right to countersign checks, limiting the purchases of raw materials, etc. This has been magnified by respondent in his brief to such statements as those appearing on page 2 of his brief, that the business of bankrupt after July 1, "was operated absolutely and exclusively for the benefit of petitioner." Similar statements appear throughout the brief.

Nothing is alleged or argued other than the fact that all of the bankrupt's accounts receivable were sold to petitioner and that it received the proceeds of the collections on all of those accounts receivable. No other damage is claimed to have resulted or been caused to bankrupt or its creditors. The contract specifically provided (R. 10c) that bankrupt would not sell or assign any of its accounts elsewhere without giving ten days' written notice to petitioner of such intention. Thus, the agreement was in the nature of an exclusive agreement whereunder bankrupt agreed to sell all of its accounts to petitioner, which is not unusual in matters of this kind. Nor could any damage or loss occur to either the bankrupt or any of its creditors. The purchase price of the accounts purchased by petitioner was 100 per cent of their face value of which 70 per cent was paid in cash at the time of the purchase and the remainder at the time of the collection of the accounts, less petitioner's charge for its services. A striking fact appearing from the record is the amount of cash actually received by bankrupt from petitioner in connection with its transactions under the contract. As we have pointed out above, on July 1, 1932 petitioner had on hand accounts theretofore purchased from bankrupt in the aggregate sum of $18,632.85. Thereafter, the total aggregate amount of all accounts assigned to petitioner was in the sum of $71,067.47 or a total of $89,700.32 in accounts in all. There remain uncollected accounts in the aggregate sum of $7,900.51 so that there is a net of $81,799.81 of all accounts involved in this lawsuit.

The record shows that bankrupt and its trustee have already received over $79,000.00 in cash with respect to those accounts. This is arrived at by taking the amount of money which the record shows, without con-

tradiction, was paid to bankrupt in connection with those accounts as follows:

(a) There was paid to bankrupt on accounts aggregating \$18,632.85 prior to July 1, 1932, the sum of (R. 317)	\$13,125.88
(b) There was subsequently paid to bankrupt in cash the sum of (R. 353-362)	64,947.47
(c) In addition, the receiver collected in cash the sum of (R. 287)	431.30
(d) The trustee the additional sum of (R. 287)	647.07
making the total cash received by bankrupt on these accounts and by its receiver and trustee in bankruptcy in the sum of	\$79,151.72

The District Court found, and the Circuit Court of Appeals approved, the allowance to petitioner of compensation according to the contract rate up to but not after the date of bankruptcy in the sum of \$823.15 (R. 296). No reason appears for not paying petitioner compensation due in accordance with the contract after the date of bankruptcy. Such payment has heretofore been authorized. (*Manufacturers Finance Co.* v. *McKey,* 294 U.S. 442, 79 L. ed. 982.) However, if we only include the amount of compensation admittedly allowable up to the date of bankruptcy and add that to the amount of cash received respecting these accounts, the total amounts to the sum of \$79,974.87. This is in respect of accounts in the total sum of \$81,799.81 or a difference of only \$1,824.94. This small difference is more than accounted for when it is considered that actually the books of petitioner were kept on the basis of accounts cleared and not on the basis of actual cash received. Thus,

if there were some small discrepancies in the accounts, or some deductions by debtors for freight allowances, discounts or other similar matters, they would have to be deducted from the small amount of difference referred to.

In addition, petitioner collected $1941.32 on these accounts pursuant to an order of the bankruptcy court. Judgment was rendered against petitioner to repay this sum to respondent (in addition to the $12,214.20 found to have been received by petitioner as a preference). If the judgment below stands as to the collections of $1941.32, respondent will be receiving $116.38 *more than 100 per cent* of the face amount of all accounts receivable involved. *In addition,* it will receive $12,214.20 as an alleged preference plus some smaller items and over $10,000.00 by way of interest.

If bankrupt had never entered into the contract with petitioner, it would have retained its accounts receivable and collected them in due course, the same as it did while the contract with petitioner was in existence. No one contends that it could have collected more on those accounts than what was actually collected on them. The only difference is that it would not have received any immediate payments but would have had to wait until the customers paid the accounts. Certainly no creditor was harmed by bankrupt receiving 70 per cent immediately and waiting until the individual accounts paid out to receive the remaining 30 per cent. And certainly no reason exists for bankrupt and its trustee now receiving more than $12,000.00 *over and above* 100 per cent of the full face amount of every account receivable assigned to petitioner.

It is obvious, therefore, notwithstanding respondent's efforts to the contrary, that the transactions presented

on this record are certainly not any different than normal transactions on accounts receivable financing between a finance company and a mercantile institution. Bankrupt received all the advantages of receiving the great percentage of its accounts receivable immediately upon shipment of the merchandise. Its total cost for all of this service during the four months prior to bankruptcy is the sum of $823.15, allowed petitioner by way of compensation, plus the small discount of 1/5 of 1 per cent of the face amount of all accounts purchased. (1/5 of 1 per cent of the $71,067.47 in accounts purchased after July 1, 1932 amounts to only $142.13.)

All of the foregoing facts, in our opinion, more than justify the argument contained in our main brief that the conclusion arrived at by the courts below is a serious departure from all of the known authorities, and, if not modified, will constitute a serious threat to the continuance of a type of financing which has always received the sanction of the courts. (*Manufacturers Finance Company* v. *McKey,* 294 U.S. 442, 79 L. ed. 982.)

III.

Respondent's brief assumes throughout that no evidence of any kind was introduced by petitioner. In so doing he completely ignores the record. While we have contended and still do contend that the burden was with the respondent in the first instance, and remained with him throughout, to establish every element of the claimed preference, petitioner does not now rest exclusively on that affirmative rule of law. On the contrary, it introduced evidence including the testimony of two witnesses E. L. Bradley (R. 159) and R. T. Hamilton (R. 182). Furthermore, and more important, it intro-

duced its ledger sheets on all transactions with the bankrupt during the period in question. Those ledger sheets were properly identified, proper foundations laid in accordance with law, and they were introduced in evidence *without objection* (R. 197, 198, 202). They were sent up in the original form to this Honorable Court and are a part of the record in this case. Those exhibits show all necessary facts to establish all of petitioner's contentions as set forth herein. They show the amount of accounts purchased, the amount of collections received on the accounts and the amount of cash paid to bankrupt in connection therewith. The entries are made daily in connection with every transaction had between the parties during the period here involved, without exception, and record the full history and picture of those transactions. The only thing which those ledger sheets do not record and which it is impossible for those ledger sheets to have recorded, is a breakdown showing the source of each individual collection. In other words, there is no breakdown on those ledger sheets showing whether or not the collections made were made on accounts assigned prior or subsequent to July 1, 1932. Two obvious reasons give a complete answer as to why such information is not shown on those ledger sheets. First, there was no reason to make any distinction between the transactions had prior to July 1, 1932 and those had subsequently. Secondly, and more important, practically all of those collections *were not made by petitioner*. On the contrary, they were made by bankrupt. Mr. Floyd, who was president of bankrupt before bankruptcy and who thereafter was appointed and remains to this day its receiver in bankruptcy, testified (R. 156) to the exact amount of moneys collected by *bankrupt* month by month during the months of July to and including No-

vember, 1932. He was then asked by his own counsel (R. 150):

"Q. 367 Is that report the actual money collected by the company during that time?

A. That is money collected by us and sent to them."

There is no other or contrary evidence in the record.

Obviously, therefore, respondent, and not petitioner, had or should have had in its possession, and was the *only one* who had the books and records showing the identity of the particular accounts as to which the collections were made. The contract provided (R. 10b) that in order to avoid objections by, and any possible loss of trade from customers through petitioner collecting the accounts directly from the debtors, bankrupt was given the right to make collections at its office of all accounts sold to petitioner, agreeing on the day of the receipt thereof, to transfer and deliver to petitioner all original checks, drafts, notes and other evidences of payment received in payment or on account of any accounts purchased thereunder. It is undisputed that bankrupt had such books, that they were left with the bankrupt at the time of bankruptcy (R. 168) and were in possession of the receiver who failed to produce them, although demand was made upon him to do so by counsel for petitioner (R. 144). Petitioner obviously produced all pertinent information and all admissible evidence in its possession on that subject when it introduced all of its ledger sheets. Those ledger sheets do not corroborate the *unsupported theory* of respondent. Nowhere is there any evidence to support such theory. Nevertheless, the preference alleged to have been received depends *exclusively* upon the *theory* that the indebtedness owing petitioner on July 1, 1932 was paid in its *entirety* out of

subsequently assigned accounts. It is respectfully submitted that such theory is not only unsupported by the record, but that it is expressly contrary to the record. Under such circumstances the claimed preference vanishes completely.

CONCLUSION.

We respectfully submit that the matter here presented to your Honors is a matter of most vital importance to financial institutions of all kind throughout the country and as well to literally thousands of business establishments who depend upon this type of financing. It is a perfectly proper, legitimate and well recognized method of financing and one that has always been recognized as sound economically and legally enforcible. The holdings of the courts below will seriously jeopardize if not destroy this type of financing. The decisions of the court below are contrary to all other reported decisions on the subject. They are expressly contrary to the decisions of the Circuit Courts of Appeals for the 2nd and 9th circuits and for the District of Columbia. The effect of the decisions below is to raise a presumption, regardless of the facts and the state of the record, that the amount owing under this type of financing on the date four months prior to bankruptcy was paid out of accounts purchased within the four month period. There is no basis in fact or in law for such a decision or presumption, and we submit that it is of the highest importance that this Honorable Court grant an opportunity to have the matter presented upon full briefs and oral argument so that the decision can be reviewed by this court and the law on the subject settled.

We respectfully pray that, all circumstances considered, this Honorable Court grant the petition and issue its writ of certiorari to review the judgment appealed from.

Respectfully submitted,

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